STANDARD & POOR'S
PUBLIC FINANCE

Publication date: 03-Jan-2006
Reprinted from RatingsDirect

Iowa Finance Authority; Housing, General Obligation

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Credit Profile

AFFIRMED

Iowa Fin Auth ICR
AA-

OUTLOOK:
STABLE

Rationale

Standard & Poor's Ratings Services affirmed its 'AA-' issuer credit rating (ICR) on Iowa Finance Authority (IFA). The rating is based on the following strengths:

- The very high quality and very low-risk profile of IFA's asset base;
- Improving financial performance;
- High debt rating (around 96% rated 'AAA') and minimal GO debt exposure;
- Stable and strong management team;
- Strong legislative support; and
- Rebounding state economy.

IFA's asset base of $755 million as of June 30, 2005, is the smallest among all housing finance agencies (HFAs) with ICRs rated by Standard & Poor's. Nonetheless, IFA's asset base is of very high credit quality and low risk. The single-family program's assets are predominantly in the form of Ginnie Mae and Fannie Mae MBS, and its multifamily loan issuance is minimal. IFA's strong asset portfolio is complemented by its sound equity position (more than 19% of assets) and improving financial performance (see Table 3). IFA has a strong management team that has repeatedly proven to be proactive and successful in meeting its mission of financing affordable housing for residents of the state of Iowa. In addition, the management team has a strong and mutually beneficial working relationship with the state Legislature.

The authority also administers, in partnership with the Iowa Department of Natural Resources, the State Revolving Fund (SRF), which issues tax-exempt bonds to finance wastewater and drinking water facilities. The SRF bonds are rated 'AAA' based on the large size and diversity of the SRF program's loan portfolios, program coverage and reserve levels, structural features, and a management team with a proven track record. Standard & Poor's analysis of the authority's ICR excludes the activities of SRF, as its funds are legally obligated to the program and hence do not contribute to IFA's finances.

IFA's title guaranty division (TGD) was established in 1985 to guarantee title to real property in Iowa. The TGD is considered when evaluating IFA's ICR, as surplus funds from TGD, in accordance with state code, are available to support IFA's affordable housing activities. In fiscal 2005, TGD transferred $2.8 million to IFA's housing assistance program funds. The risk associated with title guaranty to IFA's ICR is viewed as minimal, as adequate reserves and reinsurance are in place to cover potential claims.

Outlook

The stable outlook reflects IFA's improving financial performance given the authority's aggressive five-year strategic plan, which involves increasing its asset base to 140% of fiscal year-end 2003 levels. As expected, rapid growth in assets has led to declining leverage ratios, but Standard & Poor's does not view this as a concern given the authority's low-risk profile. Furthermore, the authority's strong relationship with state government, combined with the state's rebounding economy, should provide an environment that will enable IFA to carry out its mission and achieve its goals. The outlook reflects Standard & Poor's expectation of sustained financial performance and strong management, positioning the authority for an upward rating action should positive trends continue.

Asset Quality

IFA's asset base, the smallest of all rated HFAs, has grown by a considerable margin of about 68% over the past five years, and by about 10% in fiscal 2005 alone. As of June 30, 2005, IFA had a strong asset base totaling $755 million, consisting of single-family MBS (68%), investments (28%), and other loans receivable. The proportion of MBS and other mortgage loans in the asset portfolio has risen to 71% in 2005 from 48% of total assets in 2000, largely due to the authority's strategic plans to expand its asset base and increase profitability. At the end of fiscal 2005, IFA's loan portfolio consisted of single-family Ginnie Mae and Fannie Mae MBS (96%), and single-family whole loans and multi-family loans (4%). IFA's single-family MBS portfolio has more than doubled in size since 2001 and has increased by around 28% over 2004, due to an increase in loan origination and thus the amount of MBS purchased.

IFA's loan portfolio is extremely low risk due to the authority's conservative approach to collateral. As of June 30, 2005, more than 98% of IFA's single-family loans were backed by Ginnie Mae and Fannie Mae MBS. As expected, delinquencies and non-performing assets as of June 30, 2005 were negligible, given the low risk associated with IFA's loans. Since MBS guarantee payment on the underlying loans, no reserves are required.However, for the remaining loans, IFA has provided reserves to cover potential credit losses on the portfolio. These loans are performing well and have sufficient excess assets that cover any credit shortfall or liquidity issues.

IFA's investments as of June 30, 2005 were of sound credit quality, primarily consisting of government securities and investment agreements with 'AA-' or higher rated providers. Management takes a conservative approach to the oversight and monitoring of the authority's investments. IFA's investment income has steadily declined to just 15% of total revenues in 2005 from 35% in 2001, mainly due to low interest rates and the reduction in the percentage of investments to total assets to 28% in 2005 from 45% in 2001. Despite these drops, the authority's investments are sufficiently liquid, with more than 75% of them maturing in one year or less.

Earnings Quality And Financial Strength

Total revenues have increased steadily since 2000, with an upsurge of 21% in fiscal 2005. However, net income has fluctuated due to lower yields on loans and investments, higher operating expenses, and increasing interest expenses for bonds as IFA implements its strategic plan for growth. In addition, there have been fluctuations in the figures of grants received and disbursed over the past few years. In 2005, net income more than doubled from the previous year's level to $9.7 million, the highest since 1997. IFA's core business of issuing bonds to finance below-market rate, single-family mortgages continues to generate stable revenues. IFA also administers the private activity volume cap allocated to certain private activity bonds, and therefore acts as a conduit bond issuer for various types of financing within the state, but does not report this function in its financial statements. These activities enable the authority to earn fee-based revenue without adding to its risk profile as a housing agency.

After a two-year decline, IFA's profitability as measured by return on assets (ROA) improved to 1.35% in 2005 from 0.68 in 2004. This is mainly attributed to an increase in receipts received from state appropriations, a significant proportion of which is held in revolving loan funds. Furthermore, IFA's net interest margin (NIM) strengthened to 1.22% in 2005 from 0.98% in 2004. However, though its NIM is lower than in previous years, it is not an area of concern given the limited risk profile of the authority's existing asset base. As detailed in Table 2, the five-year average of the authority's profitability ratios are higher than those of its 'AA-' rated peers, exhibiting its strong financial performance.

IFA's equity position has increased by approximately 7% over the past year to $145 million in 2005, representing 19.27% of total assets. However, unlike other HFAs, this ratio has declined steadily from 26.61% in 2000 as a result of the rapid increase in assets in accordance with the authority's strategic plan. The authority's equity base is adequate, however, to support its low-risk profile, and reflects the authority's significant financial strength. After adjusting for potential losses, the division's sound unrestricted equity as a percentage of debt far exceeds Standard & Poor's threshold of 4% and its liquid assets are also well in excess of 2% of mortgage loans outstanding. IFA's sound capital adequacy ratios continue to indicate good management and a prudent use of authority resources.

Debt

As of June 30, 2005, IFA's debt outstanding totaled $583 million, up 11% over the preceding year and the highest level since the 1990s. Of the total, around 96% are single-family bonds with the remainder in multifamily bonds. IFA has $125 million variable-rate, single-family bonds outstanding, representing more than 21% of total debt. The use of variable-rate debt has allowed the authority to reduce its cost of debt and originate mortgage loans at competitive interest rates. The authority has utilized interest rate swaps and interest rate caps to hedge most of its floating-rate exposure. All single-family bonds issued since 1991 under the single-family MBS resolution, constituting more than 99% of the total single-family bonds and around 96% of total debt, are rated 'AAA', reflecting the extremely high quality of pledged collaterals consisting of Ginnie Mae and Fannie Mae MBS, the strong credit quality of investments, and cash-flow sufficiency. The remaining single-family bonds that are backed by single-family whole loans and the multifamily bonds (series 1978A) are rated 'AA' based on the strength of the excesses under the separate indentures. Under the series 1978A bond issue, loans are no longer outstanding and the bonds are solely secured by government obligations escrowed through bond maturity in 2021. Although IFA's GO is pledged to four out of the six parity resolutions outstanding, 96% of the bonds are held under the single-family MBS resolution, and therefore pose minimal risk to the authority's ICR. The authority's GO debt exposure ratio is 3.5%, ranking "low" on Standard & Poor's leverage scale for state HFAs.

Approximately 33% of the total debt was issued at variable interest rates. IFA has partially hedged its variable-rate risk exposure on the bonds through floating-to-fixed rate swaps and interest rate caps with providers rated at least 'A+'. IFA currently has 8 swaps and 2 caps outstanding to hedge the variable-rate debt associated with single-family bonds. Following a review of IFA's swaps and caps, Standard & Poor's assigned the agency a debt derivative profile (DDP) of '2' on a five-point scale, where '1' represents the lowest risk.

The overall score of '2' reflects:

- Two highly rated swap counterparties;
- Average economic viability of the swap due to the hedge rate being 68% of LIBOR;
- Low termination risk; and
- Good management oversight.

Standard & Poor's is not factoring in the value at risk as a contingent liability at this time due to the remoteness of involuntary termination.

Management

The authority is governed by a nine-member board appointed by the governor with the approval of two-thirds of the members of the state senate. The board is backed by an experienced professional staff consisting of 87 full-time employees, headed by an executive director who assumed office in 2005. The executive director had served as the chief financial officer of the authority since 2003 when appointed, and was involved in the initial implementation of the authority's strategic plan. The succeeding chief financial officer had served as general counsel for the authority since 2001 before being appointed to his new position. Senior management has an average tenure of five years. IFA's strong and capable management actively seeks to improve financial performance and programmatic operations.

Management is currently in the middle of increasing the scope of its mission to provide affordable housing within the state. The authority's five-year strategic plan calls for rapid growth by increasing the size of its single-family program, implementing a new multifamily program that would add a goal of $40 million in new production, increasing profitability while expanding the size of the authority, and developing other sources of revenue that will continue to keep IFA on track with its mission. Standard & Poor's views the strategic planning and its capital adequacy study as evidence of strong management. It is expected that IFA's management will be capable of balancing growth while maintaining its overall strength.

Standard & Poor's views IFA's relationship with the state as highly positive and expects this relationship to continue. The state recently approved about $10 million in appropriations for various programs run by IFA: senior living revolving loan fund, home- and community-based revolving loan fund, transitional housing for substance abuse revolving loan fund, entrepreneurs with disabilities program, and a guard/reserve homebuyer assistance program. In addition, the state approved a change to Iowa law concerning property taxes to allow the authority to refinance section 202 multifamily loans, thereby increasing IFA's flexibility, which is necessary to expanding its scope of business.

The current governor is a strong proponent of IFA and has demonstrated support for the authority. This is evidenced by his vetoes of attempts by the state Legislature in 2001 and 2003 to require IFA to contribute funds from its general fund balances to help the state handle budgetary stress. Fund balance raids weaken an HFA's financial strength and represent a risk that is largely out of the control of agency management. They also can represent dissatisfaction at the state level with the performance of the HFA. While it must be recognized that the state's financial condition can affect IFA, or any HFA, IFA has taken steps over the last few years to cultivate relationships with state legislators and increase awareness of IFA's programs and mission.

IFA has been engaged by the state over the years to take on non-housing related activities, including serving as one of the state's primary bond issuing authorities. IFA's close relationship with the state is also evident through its role as administrator for the SRF, in partnership with the Iowa Department of Natural Resources, and its role as the state's allocating agency for low-income tax credits. In addition to its active single-family program, IFA manages a number of housing development and rehabilitation programs designed to provide affordable housing and improve existing housing stock.

Economy

Iowa's economy is gradually rebounding from the national recession of 2001. Strong growth in most of the state's industries has accelerated employment expansion. Consequently, the current employment rate is higher than the previous year's level and just 1% below its pre-recession peak, while the unemployment rate at 4.5% is well below the averages for both the Midwest and the U.S. Robust industrial performance and employment growth have helped improve personal incomes and household finances. However, the rate of personal bankruptcy filings in Iowa is rising, albeit the incidence of bankruptcy in the state is still much lower than in the Midwest or U.S.

Iowa's housing affordability index is the second highest in the U.S., indicating that the housing boom that resulted in sharp house price appreciation in most areas of the country has largely evaded the state's housing market. In the first quarter of 2005, single-family house prices appreciated 5.3% compared with the same period in 2004, which is less than half of the rate of house-price growth nationwide. Neither single-family nor multifamily markets performed well in 2004, as the number of residential permits declined over the previous year, and are forecasted to decline through 2009. Furthermore, the number of mortgage originations declined by 30% in 2004 to 11,550, and are forecasted to continue declining significantly over the next four years. Housing prices also increased over the past year and are forecasted to continue to grow through 2008, despite the slowdown of originations. This appreciation, combined with the stable economy, should continue to create a need for affordable housing in the state.

Table 1 Iowa Finance Authority Financial Ratio Analysis

	2001	2002	2003	2004	2005	5-Year Average
Profitability (%)						
Return on average assets	(0.05)	1.42	0.95	0.68	1.35	0.87
Return on assets before loan loss provision and extraordinary item	0.13	1.34	1.00	0.67	1.45	0.92
Net interest margin	1.82	1.50	1.20	0.98	1.22	1.34
Asset Quality (%)						
Nonperforming assets/total loans and real estate owned	0.00	0.00	0.00	0.05	0.08	0.03
Loan loss reserves/total loans and MBS	0.00	0.00	0.75	0.45	0.42	0.32
Loan loss reserves/nonperforming assets	0.00	0.00	0.00	1,000.63	520.13	304.15
Leverage (%)						
Total equity/total assets	24.93	22.18	19.63	19.84	19.27	21.17
Total equity and reserves/total loans and MBS	45.16	37.89	32.87	31.11	26.87	34.78

Liquidity (%)						
Total loans and MBS/total assets	55.19	58.52	58.38	62.84	70.63	61.11

Table 2 Five-Year Average Financial Ratios (2000-2004)

	IFA	All 'AA-' HFAs	All 'AA' HFAs	All 'A+' HFAs	All HFAs
Profitablity (%)					
Return on average assets	0.87	0.71	1.08	0.53	0.85
Return on assets before loan loss provision and extraordinary item	0.92	0.81	1.18	0.58	0.99
Net interest margin	1.34	1.31	1.70	0.78	1.37
Asset Quality (%)					
Nonperforming assets/total loans and real estate owned	0.03	1.89	2.36	2.56	2.09
Loan loss reserves/total loans	0.32	1.19	2.43	0.84	1.53
Loan loss reserves/nonperforming assets	304.15	82.04	103.10	28.28	194.04
Leverage (%)					
Total equity/total assets	21.17	13.78	19.01	9.21	14.84
Total equity and reserves/total loans	34.78	23.39	30.21	14.56	23.87
Liquidity (%)					
Total loans/total assets	61.11	64.84	69.70	68.85	67.75

Table 3 Iowa Finance Authority Trend Analysis

	2001	2002	2003	2004	2005
Total assets ($000s)	449,921	563,855	667,798	684,461	754,715
% change	5.64	25.32	18.43	2.50	10.26
Total debt ($000s)	315,663	414,019	511,552	522,321	583,944
% change	7.50	31.16	23.56	2.11	11.80
Total equity ($000s)	112,148	125,046	131,074	135,727	145,435
% change	(1.04)	11.50	4.82	3.55	7.15
Revenues ($000s)	34,351	38,556	41,160	46,454	55,826
% change	9.64	12.24	6.75	12.86	20.17
Net income ($000s)	(225)	7,214	5,836	4,605	9,708
% change	(104.51)	3,106.87	(19.10)	(21.10)	110.81
Total loans and MBS ($000s)	248,319	329,987	389,849	429,948	533,060
% change	22.09	32.89	18.14	10.29	23.98
Nonperforming assets ($000s)	-	-	-	195	426
% change	-	-	-	-	117.93

Loan loss reserves ($000s)	-	-	2,911	1,956	2,215
% change	-	-	-	(32.81)	13.24